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SUBJECT: THE RUSSIAN ARMS DEAL WITH ALGERIA: A MODEL FOR EXPANDING THE MARKET?

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11. (C) SUMMARY. President Putin's March 10 visit to Algeria demonstrated that Russia is actively working to expand into new arms markets to sustain the Russian military-industrial complex. Russia reportedly will sell Algeria 70 combat and trainer jet aircraft, 300 T-90S tanks, air defense systems, and various other arms for a total of \$7.5 billion. The deal, made possible through Russia's agreement to write off \$4.7 billion of Soviet-era debt, catapults Algeria into the number three position behind India and China as a purchaser of Russian arms. END SUMMARY.

DEBT FOR ARMS

12. (U) High on Putin's agenda for his March 10 visit to Algeria (Ref. D) was finalizing arms contracts worth a reported \$7.5 billion. We discussed the Algeria deal and Russia's arms export strategy with Konstantin Makiyenko, Deputy Director of the Center for Strategic Analysis and Technologies (CAST). Makiyenko said that the sale to Algeria meant that Russian arms exports had "moved out of the India and China ghetto." He was referring to the fact that India and China currently buy 70 percent of Russia's arms exports. Makiyenko speculated that the deal might cause other North African countries to step up purchases of modern arms as well to keep pace with Algeria. In a press interview, Sergey Chemezov, General Director of Rosoboronexport (Russian Defense Exports) noted that 90 percent of the present arrangement involved the sale of new equipment and only 10 percent would buy upgrades or repair of materials from previous sales.

13. (C) Makiyenko told us that if Russia had insisted on Algeria paying off its debt of \$4.7 billion, the contracts just agreed would not have been signed. He said Algeria wanted the same 100 percent debt relief that Syria had received when Russia wrote off its larger debt. Makiyenko said that the Russian military-industrial complex would be a big winner, and could potentially obtain contracts for twice the amount of the original debt of \$4.7 billion. Makiyenko said that the deal would benefit most sectors of the Russian

arms industry. Half of the contracts would go to the aviation industry, and about \$1 billion each to the manufacturers of air defense systems and tanks. In addition, he told us, shipbuilders may earn several hundred million dollars.

SAVING DEFENSE INDUSTRY JOBS

¶4. (C) Aleksandr Golts, Deputy Editor-in-Chief of Yezhenedelniy Zhurnal, told us he agreed that debt relief was central to the deal. Golts doubted that Algeria would have paid off the debt anyway. He said the deal turned out to be a "win-win" situation for both sides. The Algerians can wipe off their old debt and the Russians profit by keeping the production lines in defense factories moving. Golts observed that saving defense sector jobs would pay handsome political dividends for the Putin camp in the run up to the 2008 Presidential elections.

¶5. (C) Aleksey Arbatov, former Duma Defense Committee Vice Chairman, also agreed that Russia's military-industrial complex would benefit from these Algerian arms contracts. Arbatov noted Algeria is a good market for Russia since it does not provoke the same political sensitivity as do Russian sales to Iran, Syria, or Venezuela. Russia has no vital interests in North Africa, he remarked, and its approach is "all commercial."

¶6. (C) Aleksandr Belkin, Deputy Executive Director of the Council on Foreign and Defense Policy (CFDP), told us that Putin's trip to Algeria "killed two birds with one stone."

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First, Russia re-established strategic relations with Algeria that had been adrift for over a decade. Second, Russia diversified its arms clients by expanding out of its heavy reliance on India and China. However, Belkin underlined that the arms industry alone is not a suitable base for Russian industry. Only serious investment and development of civilian industries will improve the overall health of the Russian economy, he said. Belkin pointed out that the fall of the Soviet Union was due in part to over-spending on defense industry and insufficient attention to the civilian sector.

¶7. (C) Belkin noted that Russia has been relying on Soviet-era stockpiles and Soviet-designed weapons since the end of the Cold War. The current lack of strategic depth, not only in material but in trained personnel and ideas, will challenge Russia's ability to stay competitive in arms markets. While the Soviet Union's defense industry received the best engineers, technicians, and students, Russia's defense industry today is not getting "the best and the brightest."

ALGERIA'S MILITARY REARMS

¶8. (U) The announced \$7.5 billion deal is reported to include contracts for 36 MiG-29 SMT fighters, 28 Su-30 MKI fighters, and 14 Yak-130 jet trainers (aircraft contracts alone worth \$3.5 billion). Additionally, 36 earlier-model MiG-29 fighters would be returned to Russia and resold to other countries. Algeria will buy 300 T-90S tanks over four to five years (worth \$1 billion), eight divisions of S-300 PMU air defense systems (\$1 billion), and 30 Tunguska air defense systems (nearly \$500 million). Russia will also upgrade 250 T-72 tanks (over \$200 million), supply Metis and Kornet anti-tank missiles, and repair vessels for the Algerian Navy.

¶9. (C) According to Makiyenko, however, of the \$7.5 billion, only \$5.5 billion of the sale can be accounted for (the aircraft, new T-90S tanks, and the S-300 PMU air defense

systems). There was no transparency regarding the rest of the \$2 billion, he noted. Additionally, Belkin doubted the Russian defense industry could support making 300 new tanks, even over several years as reported. Belkin predicted that Algeria might instead receive refurbished older tanks.

¶110. (U) Marat Kenzhetayev, an analyst from the Disarmament Studies Center in Moscow, told the press that Algerian contracts would represent a virtual rearming of the Algerian military. Between 1962 and 1991, Algeria bought \$10 billion worth of arms from the Soviet Union. However, Kenzhetayev noted, during the 1990s its orders didn't exceed \$500 million and since 2000 have been less than \$100 million.

¶111. (C) Makiyenko predicted to us that Libya would not want to fall behind militarily, though there was more a "pride race" between Algeria and Libya than an arms race. General-Colonel Sergey Mayev, First Deputy Director of the Russian Federal Defense Order Service, took the same public line, telling media representatives that the Algerian contract opens prospects for promoting Russian armored vehicles to Libya, Syria, and Iran.

¶112. (C) Neither Makiyenko nor Belkin saw a military necessity for Algeria to purchase that quantity of arms. Makiyenko speculated that the Algerian President authorized the purchase to obtain "toys for his military boys" to keep them off of his back. He understood that there was some discord between the Algerian President and his top military brass, and the deal might be part of an attempt to buy them off.

ALGERIA IN THIRD PLACE; IMPLICATIONS FOR CHINA AND INDIA

¶113. (C) The deal would make Algeria the number three purchaser of Russian arms, after China and India. Makiyenko predicted that Algeria might become the number one client of Russian arms over the next several years, as the Indian and Chinese markets for Russian arms level off or decline. The Chinese, he said, are tired of receiving "stripped-down" versions of Russian arms and are looking to other suppliers,

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especially from Europe. If the European Union (EU) decided to lift its arms embargo against China, he speculated, China could use a threat to buy modern weapons from Europe to extract a deal for fully-equipped arms from Russia. The Chinese had made it clear they wanted "the good stuff."

MiG EMERGES AS A WINNER

¶114. (C) Makiyenko told us the Algerian contract essentially guarantees the future of MiG Aviation, which had been suffering in its competition with the more powerful Sukhoi. An on-again, off-again MiG deal to India could be revived thanks to the Algerian contract, he said, and predicted the Algerian deal could revive MiG's chances to re-enter the contest for designing a fifth-generation fighter (won by Sukhoi in 2001).

COMMENT

¶115. (C) While there is still a lack of clarity regarding the actual value of the deal, it will give a much needed boost to the Russian military-industrial complex. Enterprises employing thousands, often located in remote and depressed regions, can expect steadier employment for the next several years as a result of the deal with Algeria. Saving jobs in the defense industry sector should pay important political dividends to Putin and his allies as the 2007-2008 election cycle approaches. The Algeria deal makes clear that the GOR

is pushing to expand the market for Russian arms beyond its current focus on China and India. We can expect to see more use of innovating financing, such as debt write-offs, as an incentive to move deals forward and keep the Russian defense industry's production lines moving.

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